

Summary of "The Dodd-Frank Wall Street Reform and Consumer Protection Act"

The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203, July 21, 2010, hereafter the "Dodd-Frank Act") was enacted in the wake of what many believe was the worst U.S. financial crisis since the Great Depression. Among other things, the Dodd-Frank Act creates a new Financial Stability Oversight Council ("FSOC") with the authority to designate certain financial firms as "systemically significant," thereby subjecting them to increased regulation; consolidates consumer protection responsibilities in a new Consumer Financial Protection Bureau ("CFPB"); consolidates bank regulation by merging the Office of Thrift Supervision ("OTS") into the Office of the Comptroller of the Currency ("OCC"); requires more derivatives to be cleared and traded through regulated exchanges; and attempts to reduce the incentives to take excessive risks by reforming executive compensation and securitization.

The Dodd-Frank Act contains more than 300 provisions that expressly indicate that rulemaking is required or permitted. However, it is unclear how many rules will ultimately be issued pursuant to the act because, among other things, (1) most of the provisions appear to be discretionary (e.g., stating that an agency "may" issue a rule); (2) individual provisions may result in multiple rules; (3) some provisions appear to provide rulemaking authorities to agencies that they already possess; and (4) rules may be issued to implement provisions that do not specifically require or permit rulemaking.

Nearly 80% of the relevant provisions in the Dodd-Frank Act assign rulemaking responsibilities or authorities to four agencies: the Securities and Exchange Commission ("SEC"), the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission ("CFTC"), and the CFPB. Many of the mandatory provisions specify the details of the rules to be issued, but many of the discretionary provisions allow the agencies to issue such rules "as may be necessary." Most of the rulemaking provisions in the act do not indicate how the regulations should be developed, but some either require or prohibit notice and comment procedures before the final rule is issued. Fewer than 40% of the rulemaking provisions in the Dodd-Frank Act indicate when the required or permitted rule should be issued or go into effect.

Title X of the Dodd-Frank Act consolidates many federal consumer protection responsibilities into the new CFPB within the Federal Reserve System. The Dodd-Frank Act transfers supervisory and enforcement authority over a number of consumer financial products and services to the CFPB on July 21, 2011. Title X and Title XIV of the Dodd-Frank Act contain numerous provisions that require or permit the CFPB to issue regulations implementing the statute's provisions. The CFPB's authority varies according to the type of company, and the statute explicitly exempts certain entities and activities from the CFPB's authority.

Section 1022 of the Dodd-Frank Act alone gives the CFPB broad rulemaking powers, authorizing it to prescribe such rules "as may be necessary or appropriate" to enable the CFPB to administer federal consumer financial protection laws. The Dodd-Frank Act contains many other provisions that require or permit the CFPB to issue rules, most of which give the CFPB substantial discretion regarding whether rules must be issued, what the contents of those rules must be, and when they must be issued. The CFPB also assumes responsibility for certain transferor agencies' existing rules, proposed rules that have not been made final, and final rules that have not taken effect. Although most of the CFPB's rulemaking authority and discretion is the same as it was before being transferred from the safety and soundness (prudential) regulators, it is not clear that those authorities and discretion will be exercised in the same way.

Congress empowered the newly created Financial Stability Oversight Council (composed primarily of the heads of the prudential regulatory agencies from which the CFPB was formed) to “stay” or “set aside” all or part of a CFPB rule that it concludes would put the safety and soundness of the U.S. banking or financial systems at risk.

Congress created the CFPB as an independent regulatory agency within the Federal Reserve System (which is, itself, an independent regulatory agency). Such agencies are intended to be more independent of the President than cabinet departments and other executive branch agencies. The CFPB is to be headed by a director, who is appointed by the President, with the advice and consent of the Senate, to a five-year term of office. The director can only be removed from office for “inefficiency, neglect of duty, or malfeasance in office.

Some portions of the Dodd-Frank Act went into effect on the date of enactment, while many other parts of the statute go into effect on the “designated transfer date” of July 21, 2011.” Section 1063(i) requires the CFPB, no later than the designated transfer date of July 21, 2011, to consult with the head of each agency transferring consumer protection functions and “identify the rules and orders that will be enforced by the CFPB.” The agreed-upon list of rules and orders must be published in the Federal Register. Section 1063(j) states that, “Any proposed rule of a transferor agency which that agency, in performing consumer financial protection functions transferred by this title, has proposed before the designated transfer date, but has not been published as a final rule before that date, shall be deemed to be a proposed rule of the Bureau.” It also says that, “any interim or final rule of a transferor agency which that agency, in performing consumer financial protection functions transferred by this title, has published before the designated transfer date, but which has not become effective before that date, shall become effective as a rule of the Bureau according to its terms.”

In addition to creation of the CFPB, the Dodd-Frank Act will implement the following major provisions:

1. Deposit Insurance

- \$250,000 deposit insurance limit effective immediately. Some details may need to be addressed in regulation.
- Transaction Accounts, defined as non-interest bearing, to have unlimited deposit insurance for two years beginning December 31, 2010. Coverage is automatic, no additional premium; existing TAG program continues through the end of 2010.
- Assessment Base changed from deposits to assets on day of enactment, but FDIC must write regulations to deal with significant implementation issues for the change to become operative. Expected toward end of 2010, with likely application for the first quarter of 2011.
- DIF recapitalization plan: FDIC to revise recapitalization plan in the fall of 2010, to include new minimum DIF ratio of 1.35% to be reached by 2020, a new Designated Reserve Ratio (long-run target), and consider whether to include a dividend policy (made optional under the Dodd-Frank Act) once targeted ratio is reached.

2. Merger of OCC and OTS

- By mid-January 2011, OCC, OTS, FDIC, and Federal Reserve must submit joint plan for merger, to be completed by July 21, 2011. The OCC-OTS Transfer Date can be extended by 6 months.

- Changes in Bank Supervisors: Supervision of all federal savings associations goes to OCC; state-chartered savings associations to FDIC; all bank and S&L holding companies to Federal Reserve on OCC-OTS Transfer Date.
- On the OCC-OTS Transfer Date, Federal Reserve acquires responsibility to supervise non-depository subsidiaries of holding companies.
- On OCC-OTS Transfer Date, Federal Reserve obtains authority to set capital standards for bank and S&L holding companies.

3. Prudential Supervision

- Position of Federal Reserve Board Vice Chairman for Supervision is created.
- Collins Amendment on Capital: BHCs over \$500 million may not count newly-issued trust preferred securities as capital; BHCs over \$15 billion must phase out existing TruPS from capital. Banks/thrifts and holding companies will become subject to the same minimum capital rules.
- On OCC-OTS Transfer Date parent companies of insured banks and savings associations can be required to serve as source of strength for insured institutions
- After the OCC-OTS Transfer Date, all financial holding companies required to meet well-capitalized/well-managed tests. S&L holding companies must meet well-capitalized/well-managed tests to engage in financial activities otherwise only permitted for financial holding companies. Well-capitalized/well-managed test required for interstate mergers/acquisitions.
- Credit exposure on derivatives included in national bank lending limit, beginning July 21, 2011. Applied to state bank lending limits, beginning January 21, 2012.
- Charter conversions prohibited where there is a pending enforcement order/MOU
- De novo branching allowed for out of state banks wherever permitted for in-state banks.
- Insider lending restrictions expanded to include derivative, repos and reverse repos, and securities lending/borrowing, beginning one year after OCC-OTS Transfer Date.
- Interest on business checking: starting July 21, 2011, banks will be permitted to pay interest on business checking accounts.
- References to credit ratings removed from statutes, effective July 21, 2012.

4. New Savings Association Rules

- As of date of enactment, failure of Qualified Thrift Lender test by a savings association no longer requires conversion to a bank charter, but rather results in being subject to same activity, branching, and dividend restrictions applicable to national banks.
- Unitary thrifts that conduct non-financial activities may be required by the Federal Reserve, no sooner than within 90 days of OCC-OTS Transfer Date, to form an intermediate holding company to conduct some or all financial activities.
- Mutual holding company dividends: as of the OCC-OTS Transfer Date, savings association subsidiaries of mutual holding companies must give banking regulators 30-day prior notice of dividend declarations, and mutual holding companies must provide regulators with 30-day prior notice of any waiver to receive dividends.

5. Mortgage Markets

- Most mortgage provisions of the Dodd-Frank Act are to be under the jurisdiction of the CFPB, but many of the regulations are to be developed by the Federal Reserve or other agencies as specified below.

- 18 months after OCC-OTS Transfer Date, the Federal Reserve is to publish regulations on a variety of mortgage origination topics, including steering consumers, discrimination, abusive or unfair lending practices, predatory lending.
- 18 months after OCC-OTS Transfer Date, the Federal Reserve is to publish rules setting minimum standards for mortgage underwriting. A "qualified mortgage" safe harbor is created for mortgages meeting these standards.
- New definition established for "high-cost mortgages" imposing significant restrictions on mortgages that come under the definition.
- Mortgage creditors will be required to establish escrow accounts, with some exceptions, effective by Federal Reserve Board rule 18 months after OCC-OTS Transfer Date.
- Bank regulators and the SEC are to issue rules by about mid-April 2011 setting 5% risk retention requirements for mortgage-backed securities; rules become effective one year after publication. Bank regulators, HUD, and FHFA are to define "qualified residential mortgages", exempt from risk retention requirements; no deadline for creating definition.

6. Interchange and Debit Card Processing

- By April 21, 2011, Federal Reserve to publish rules limiting debit card interchange fees to "reasonable" and "proportional" to transaction size. Exemptions for government-issued cards and for banks with less than \$10 billion in assets. Rules to become effective July 21, 2011.
- The Federal Reserve must finalize rules by July 21, 2011 banning requirements that debit card transactions be processed through any one particular network.

7. Securities, Swaps and other Derivatives

- SEC/CFTC joint authority to regulate swaps markets, effective mid-July 2011, including swap data reporting requirements; registration of swaps clearing organizations, swap execution facilities, and designated contract markets.
- Exemption from SEC filing for asset backed securities ("ABS") held by fewer than 300 persons repealed, with SEC authority to provide rules that vary according to classes. SEC to issue regulations setting new disclosure requirements for all ABS issuers.
- SEC to issue rules requiring ABS issuers to conduct a review of underlying ABS assets.
- By mid-April 2011 SEC is required to issue regulations on conflicts of interest involving ABS, applicable to underwriters, placement agents, initial purchaser/sponsor, or any affiliate or subsidiary thereof.
- By about mid-April 2011, bank regulators and the SEC are to issue rules setting risk retention requirements for ABS classes other than mortgages; rules become effective two years after publication.

8. Employee Compensation

- SEC is directed to issue rules requiring public disclosure of executive compensation, including relationship with the company's actual performance; and also disclosure of median compensation of all employees (other than the CEO), total compensation of the CEO, and the ratio of these two amounts.
- National stock exchanges directed to prohibit, by mid-July 2011, listing securities of firms that do not have independent compensation committees.

9. Corporate Governance

- For the first shareholder meeting occurring after January 21, 2011, SEC-registered firms must provide for a non-binding shareholder "say on pay" vote on executive compensation, and a vote on whether to vote again in 1, 2, or 3 years.
- After January 21, 2011, SEC registered firms must provide for a non-binding vote on "golden parachutes," if shareholders are voting on a business combination.
- Upon enactment, SEC is authorized to revise rules to facilitate ability of shareholders to nominate board members.
- Upon enactment, non-accelerated filers under Sarbanes-Oxley not subject to section 404(b) requirements for attestation by outside auditors.

10. Systemic Supervision Issues

A. Financial Stability Oversight Council (FSOC)

- Established immediately, made up of 15 members, including all financial regulators. Chaired by Treasury Secretary. First meeting; October 1, 2010.
- Duties include identifying systemically important non-bank financial institutions and subjecting them to enhanced supervision; making recommendations to the Federal Reserve and other financial regulators regarding systemic risk supervisory standards, risk management, living wills. Includes the responsibility to consider systemic impact of accounting standards.
- Also tasked to provide policy guidance to FDIC for resolution of systemically significant firms.
- Immediate responsibility will include coordination of regulatory efforts and facilitating information sharing. Also tasked to give guidance to Office of Financial Research.
- Has unworkable authority to overrule CFPB regulations.

B. Systemic Supervision Generally

- All bank holding companies (BHCs) with \$50 billion or more in assets immediately subject to enhanced prudential supervision; FSOC can vote to add other BHCs and non-banks to the list; details to be developed, but likely to result in additional capital and liquidity standards, and in potential limitations on activities/practices.
- Concentration limit, financial firms: prohibiting mergers or acquisitions resulting in a firm holding more than 10% of financial industry liabilities. The ban is effective immediately but is subject to a 6-month study by the FSOC and subsequent modification by Federal Reserve rule making 9 months after the study. Exceptions permitted (with Federal Reserve approval) for acquisitions of endangered firms.
- Concentration limit, banks and savings associations: prohibiting interstate merger/acquisitions of insured depository institutions resulting in a firm holding more than 10% of U.S. insured deposits. Exceptions allowed in cases involving FDIC assistance.
- Federal Reserve approval required, after the OCC-OTS Transfer Date, for any acquisition of non-bank firm by BHC having more than \$10 billion in assets.
- "Volcker Rule" prohibitions on proprietary trading and sponsorship/investment in hedge funds and private equity funds go into effect earlier of July 21, 2012, or 12 months after agencies write rules. Any required divestitures must be completed within 2 years after

effectiveness of Volcker Rule; deadline can be extended for up to 3 times for one year each time.

- Federal Reserve, in consultation with other bank regulators and SEC, to provide to Congress by mid-January 2011, results of a study of the credit market impact of risk retention requirements of the Dodd-Frank Act and FASB rules 166 and 167.
- Federal Reserve required to publish by December 1, 2010, detailed information on users of any of its recent emergency facilities (through July 21, 2010).
- Going forward, Federal Reserve required to release information, including rates and terms, on firms that use emergency credit facilities, discount window, and open market operations, within 1 or 2 years following the activity (release date varies according to the activity).
- Upon enactment FDIC given emergency stabilization authority with Federal Reserve, Treasury, and Congressional sign-off. FDIC might develop in 2010 and publish some guidelines regarding its use/procedures. FDIC's systemic risk exception authority (used in recent months for TAG and TLGP) is repealed.

C. Systemic Resolution

- Effective immediately, FDIC has systemic resolution authority, applies to holding companies and designated non-bank financial firms; triggered by approval of Treasury Secretary and various agencies relevant to the firm. Does not apply to federally insured banks/thrifts. FDIC on September 17 issued interim regulations. Losses paid for by fees assessed by FDIC on all systemically significant firms.
- Effective immediately, FDIC has back-up examination authority for troubled firms subject to systemic resolution authority; FDIC likely to develop an examination program in the Fall 2010.

D. Office of Financial Research.

- Immediately authorized to begin operations, has authority, including subpoena authority, to ask for any information it considers necessary to consider systemic risk issues.
- Likely to spend initial weeks setting up a research plan and priorities.
- Develop program for obtaining data, including new data submission mandates on banks of any size potentially.